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MERLAND

EXPLORATIONS LIMITED

ANNUAL REPORT

DECEMBER 31st, 1971



MERLAND EXPLORATIONS LIMITED

SUITE 500, 360 BAY STREET, TORONTO 1, ONTARIO, CANADA

OFFICERS

GEO. T. SMITH, B.A.Sc. - - - - - President
JOHN A. CAMERON - - - - - Vice-President
K. P. ALEXANDER, C.A. - - - - - Secretary-Treasurer
KAZUO TAKAI - - - - - Asst. Treasurer

DIRECTORS

JOHN A. CAMERON - - - - - Toronto
ROBERT LAW, Q.C. - - - - - Toronto
W. O. PARLEE, Q.C. - - - - - Edmonton
C. S. ROBINSON - - - - - Sidney, B.C.
GEO. T. SMITH, B.A.Sc. - - - - - Toronto
D. R. WATT - - - - - Toronto

AUDITORS

PEAT, MARWICK, MITCHELL & CO.,
Chartered Accountants,
P.O. Box 31,
Commerce Court Postal Station,
Toronto, Ontario.

REGISTRAR AND TRANSFER AGENT

GUARANTY TRUST COMPANY OF CANADA,
311 - 8th Avenue S.W., Calgary, Alberta
540 Burrard Street, Vancouver, B.C.
88 University Avenue, Toronto, Ontario.

BANKERS

THE ROYAL BANK OF CANADA,
20 King Street West, Toronto 1, Ontario.

LISTED

Shares Listed The Toronto Stock Exchange.

MERLAND EXPLORATIONS LIMITED

DIRECTORS' REPORT TO SHAREHOLDERS:

Your directors are pleased to present this Report on the Company's affairs for the twelve month period ending December 31, 1971, together with the audited financial statements.

HIGHLIGHTS

- Nine wells were drilled on Merland properties in the Jarrow and Westlock areas of Alberta, three at no cost to the Company. Seven wells were completed as gas producers and two abandoned. Gas from the Jarrow area is being delivered to Trans-Canada Pipelines at a rate of 2 million cubic feet per day. Four to six wells will be drilled by others on these holdings under farmout arrangements. Merland's proven and probable gas reserves are in the order of 12 billion cubic feet.
- In Jamaica a promising base metal discovery has been made in the Hope Mine Area near the capital city of Kingston. Initial trenching and diamond drilling has exposed a mineralized deposit, predominantly zinc and lead with silver and gold values. An accelerated programme of trenching and drilling is underway. Merland has working and indirect interests totalling 40% in the licenses.
- Parquet Flooring Division sales were substantially higher in 1971 and profits increased to \$88,000. The acquisition of this manufacturing company in 1970 has proven to be an excellent investment and it should continue to prosper and maintain its share of the commercial and housebuilding market.
- Merland shares were listed for trading under the Oil Section of The Toronto Stock Exchange in December 1971 and subsequently, the Company withdrew its shares from trading on the Vancouver Stock Exchange.

FINANCIAL

In the fiscal year ended December 31, 1971, the Company reported an operating profit of \$3,955, but will show a substantial increase in its deficit account due to a write down on marketable securities of \$221,774 and a write off of investments in an exploration company and project exploration expenses of \$98,991. It is management's opinion, supported by the break up values and earnings potential behind its securities that a substantial recovery in the investment portfolio can be anticipated.

The Company's working capital has improved by \$115,000 following the April 1972 cash sale of a portion of its Jarrow area reserves and is now approximately \$425,000. The discounted present worth of the newly acquired gas reserves and gathering system in Jarrow and Westlock are conservatively estimated to be in excess of \$500,000.

Day to day operations in 1972 will produce a modest cash flow with exploration funds being provided from the sale of properties. Developments in Jamaica might well require the consideration of some financing in the near future.

PETROLEUM EXPLORATION

Jarrow:

Since acquiring this 53,000 acre property in the spring of 1971 seven wells have been drilled of which five were completed as gas producers. In the north part of the acreage, Merland drilled five wells, completing three and abandoning two. Merland's working interest share of proven and probable reserves in this area is estimated to be 9 billion cubic feet of gas. Two million cubic feet of gas per day is currently being delivered to Trans Canada Pipelines under a 25 year contract at prices of 18¢ per thousand cubic feet, plus escalation. Unitization of reserves is underway with Merland acting as Manager/Operator of the Unit.

In the south part of the acreage, two successful gas wells were drilled under a farmout to the Ranger-Pennant Group, at no cost to the Company. Subsequently Merland sold its interest in these two wells to the farmees, realizing a profit of \$110,000.

The Company retains a 40-50% interest in 32,500 acres of undeveloped land in Jarrow, part of which has been earned with the balance under option from King Resources Company.

The prospects are favourable for substantially increasing the size of presently developed reserves and negotiations are underway for two wells to be drilled under farmout, at no cost to Merland.

Aden:

Merland and its partner Francana Oil & Gas Ltd. have farmed out 640 acres for a well which is to be drilled to test all potential zones down to the top of the Mississippian (approximately 3,200 feet). It is expected that drilling will commence shortly and this hole will help in evaluating 2,720 acres of offsetting leases in which Merland has working interests of 10 to 45 percent.

Future Exploration:

Merland has acquired a regional geological study covering some 200 Townships to the north of its Westlock acreage, extending into Marten Hills. This is an area which is sparsely drilled and has considerable potential for shallow gas. The geological mapping suggests that there are at least twenty prospective areas on which drilling can be recommended, some of which have reserve potentials of up to 100 billion cubic feet. Merland intends to acquire land in this area by purchase of Crown lands and by farm-in from other companies and then to explore the prospective areas by drilling. It is planned to spend \$500,000 on this programme in 1972 and an additional \$500,000 in 1973. The company intends to raise part of the funds for the programme from other exploration companies who will participate in the project.

Because of the increasing shortage of natural gas and the expected increase in prices the Company is highly optimistic that this project will result in a major expansion in Merland's reserves and revenues.

MINERAL EXPLORATION

Jamaica:

Since 1969, the Company's rather extensive explorations programme in Jamaica, has uncovered a number of areas with intriguing metal possibilities, deserving additional work. Its attention however, has recently been concentrated on an area, referred to as the old Hope Mine property, located a mile or two from the northeastern outskirts of Kingston. Work, entailing diamond drilling and trenching, is underway in an effort to establish the limits of a recently discovered zone of lead-zinc mineralization, which also appears to have appreciable silver and gold values.

The history of the old Hope Mine proper dates back to the time of the Spanish occupation during the fifteenth and seventeenth centuries. Records indicate that the old workings were mined for lead, zinc and silver and subjected to exploratory efforts at various intervals over the centuries. The most recent mining operation appears to have occurred around the middle of the nineteenth century. The workings were reopened and the immediate mine area was examined in some detail during the early and mid fifties largely, it seems, in search for copper. Though it was estimated that the Hope Mine zone still had remaining

some 200,000 tons of mineralization grading between 10 and 20% lead-zinc combined plus gold and silver values, little effort was extended in search of these metals outside the mine area itself.

In the Fall of 1971, Merland cut a grid with the base line stretching slightly east of north for 2,200 feet. Cross lines at 200 foot intervals were extended approximately 1,500 feet in both east and west directions. The most northerly of the old Hope Mine workings, the No. 1 Adit, is located near the vicinity of line 4 South on the base line. The recent metal discovery is located topographically higher and 6 to 8 hundred feet north of the No. 1 Adit.

Detailed geochemical soil samples along lines 0, 2 and 4 North for several hundred feet on both sides of the base line indicate a major anomalous condition. Trenching along lines 0, 2 and 4 North, near the base line has uncovered a highly weathered and oxidized zone of lead-zinc mineralization over 30 to 50 foot widths. Both the mineralization and rock association resemble those found in the old workings. The mineralization also appears to be concentrated in a brecciated zone, which strikes in a northeasterly direction along the base line, dipping roughly 45 degrees to the northwest. Aerial photographic study indicates that the zone extends for a half mile north beyond the limits of the original grid system. The grid now extends 3,500 feet north of the No. 1 Adit and detailed examination of the area is underway.

A geochemically anomalous situation, located in the area of the Hope Flats on Line 16 South, several hundred feet downhill below the old workings is now considered to be of minor significance. Diamond drill hole No. 1, located on an I.P. anomaly and drilled to a depth of 300 feet was barren.

Diamond drill hole No. 2, drilled to a depth of 396 feet and located midway between lines 6 and 4 South about 400 feet west of the No. 1 Adit found minor values. This appears to be the southerly limit of the main zone.

Diamond drill hole, No. 3, located on line 2 South - 450 West and about 600 feet northwest of the No. 1 Adit, is presently drilling at a depth of 400 feet in the expectation of intersecting the down-dip extension of the main zone.

The working interest partners have budgeted \$90,000 to support the current drilling and trenching programme through to the end of July. The Company's geologists feel confident that exploration activity now underway will define the economic dimensions of the deposit within that period. The exploration licenses covers an area of approximately 14 square miles, fully protecting the area of interest.

MANUFACTURING

Parquet Division:

The Parquet Flooring Company division has once again made an important contribution to the Company's cash flow and profits. In 1971 sales returned to anticipated levels and a profit of \$88,471 was achieved. The Division looks forward to continuing good business tempered only by the possible short supply of raw material.

* * * * *

The Board of Directors wishes to express its appreciation for the contributions made by the Company's staff, exploration personnel and technical consultants. Your Company's management is determined to achieve the maximum exposure to exploration possibilities both in the mineral and petroleum fields and will continue to keep its shareholders advised of all significant developments.

Submitted on behalf of the Board,

May 26th, 1972.

GEORGE T. SMITH, President.

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

December 31, 1971

with comparative figures for 1970 (note 1)

LIABILITIES

	ASSETS		LIABILITIES	
	1971	1970	Current liabilities:	1971
Current assets:				
Cash	\$ 55,019	\$ 2,798	Accounts payable and accrued expenses	\$ 128,544
Marketable securities, at aggregate cost less provision for decline in value (quoted market value 1971 — \$319,562; 1970 — \$444,204) (note 3)	319,562	586,765	Sales and other taxes payable	13,881
Accounts receivable	198,045	79,040	Income taxes payable by a subsidiary company ..	897
Income taxes recoverable by subsidiary company	—	483	Funds received in advance as project operating manager	4,237
Inventories, at the lower of cost or replacement cost	77,365	85,905	Bank advances repayable within one year (note 5) ..	162,000
Mortgage principal due within one year	4,839	4,468	Total current liabilities	309,559
Prepaid expenses	662	1,514	Accounts payable (note 5)	38,000
Total current assets	655,492	760,973	Due to vendor of shares in a subsidiary	—
7½ % mortgage receivable	131,310	136,165	Bank advances (note 5)	450,000
Less current portion	4,839	4,468	Less amount due within one year	162,000
	126,471	131,697		288,000
Fixed assets at cost less accumulated depreciation:			Shareholders' equity:	
Building, machinery and equipment	181,185	174,948	Capital stock (note 4):	
Less accumulated depreciation	109,909	93,837	Authorized — 7,500,000 shares without nominal or par value	
	71,276	81,111	Issued and fully paid — 4,082,500 shares (1970 — 4,065,000 shares)	1,943,282
Land	42,000	42,000	Deficit	(1,126,141)
	113,276	123,111		817,141
Project expenses at cost, less amounts written off:			On behalf of the Board:	
Interests in petroleum and natural gas leases, rights and gathering system together with development thereon	260,426	129,118	GEORGE T. SMITH, Director.	
Deferred mining exploration costs	123,600	153,134	JOHN A. CAMERON, Director.	
	384,026	282,252		
Shares in mining and oil exploration companies, at cost (note 2)	86,000	133,548		
Expenses on issue of shares	86,687	86,687		
Incorporation expenses	748	748		
	\$1,452,700	\$1,519,016	See accompanying notes to consolidated financial statements.	\$1,452,700
				\$1,519,016

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

Year ended December 31, 1971

with comparative figures for the fifteen months ended December 31, 1970 (note 1)

	Year ended December 31, 1971	Fifteen months ended December 31, 1970
Funds provided:		
Bank advances due after one year (note 5)	\$ 288,000	—
Accounts payable excluded from current liabilities (note 5)	38,000	—
Recovery of costs of marketable securities pledged as deposits to cover work commitments on exploration permits	—	101,598
Due to vendor of shares in a subsidiary	—	213,500
Proceeds from issue of share capital	8,750	—
Proceeds from transfer or sale of interests in exploration projects ...	—	50,000
Proceeds from sale of interests in projects	7,200	43,000
Reduction of long term portion of mortgage	5,226	5,535
Total funds provided	347,176	413,633
Funds used:		
For operations:		
Net loss	323,977	155,410
Deduct (add) charges (credits) not involving funds:		
Gain on sale of interests in projects	(6,906)	(92,384)
Depreciation	20,238	18,964
Investment in mining exploration company written off	47,548	—
Project exploration expenses written off	51,443	48,192
	112,323	(25,228)
Funds used for operations	211,654	180,638
Acquisition of fixed assets, including in 1970 those relating to the Parquet flooring operations	6,237	135,789
Project exploration expenses, net of amounts recovered	157,677	240,368
Investment in shares of mining and oil exploration companies	—	36,000
Payment to vendor of shares in a subsidiary	213,500	—
Total funds used	589,068	592,795
Net decrease in working capital	\$ (241,892)	\$ (179,162)
Working capital, beginning of period	\$ 587,825	\$ 766,987
Working capital, end of period	345,933	587,825
Net decrease in working capital	\$ (241,892)	\$ (179,162)

See accompanying notes to consolidated financial statements.

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF PROFIT AND LOSS AND DEFICIT

Year ended December 31, 1971

with comparative figures for the fifteen months ended December 31, 1970 (note 1)

	Year ended December 31, 1971	Fifteen months ended December 31, 1970
Oil and natural gas:		
Sales of crude oil and natural gas	\$ 1,135	\$ 3,241
Operating expenses applicable thereto:		
Operating costs	966	1,285
Royalties	—	257
	966	1,542
Excess of proceeds of sales of crude oil and natural gas over operating expenses exclusive of depreciation and amor- tization	169	1,699
Parquet flooring:		
Net sales	525,010	314,172
Cost of sales:		
Materials	219,824	139,069
Labour	107,817	57,605
Factory expenses, including depreciation of \$16,072 (1970 — \$12,678)	60,538	50,341
	388,179	247,015
Gross profit	136,831	67,157
Direct selling, general and administrative expenses	48,360	33,206
Net profit on Parquet flooring	88,471	33,951
	88,640	35,650
Other income:		
Gain on sale of interests in projects — net	1,498	92,384
Management fees	31,281	18,710
Interest	9,996	21,615
Dividends	3,850	4,675
Sundry other income	4,181	555
	50,806	137,939
Carried forward	\$ 139,446	\$ 173,589

	Year ended December 31, 1971	Fifteen months ended December 31, 1970
Brought forward	\$ 139,446	\$ 173,589
General and administrative expenses, net of amounts allocated to projects:		
Management fee	30,000	23,300
Interest and bank charges	27,093	20,225
Salaries	23,984	18,277
Legal and audit fees	17,536	20,167
Transfer agent's fees	2,646	5,037
Travel	6,305	7,878
Depreciation	4,166	6,286
Office rental	4,352	5,070
Special reports and annual meeting	3,057	4,157
Telephone and telegraph	2,304	3,954
Consulting fees	6,835	3,606
Other	7,213	12,350
	<u>135,491</u>	<u>130,307</u>
	3,955	43,282
Other charges:		
Investment in mining exploration company written off	47,548	—
Project exploration expenses written off	51,443	48,192
Increase in provision for decline in value of marketable securities (note 3)	45,085	150,000
Loss on sale of investments — net	176,689	—
Listing expense for Toronto Stock Exchange	4,067	—
	<u>324,832</u>	<u>198,192</u>
Net loss before taxes on income	(320,877)	(154,910)
Taxes on income of a subsidiary company	3,100	500
Net loss	(323,977)	(155,410)
Deficit, beginning of period	802,164	646,754
Deficit, end of period	<u>\$1,126,141</u>	<u>\$ 802,164</u>
Net loss per share outstanding	<u>\$.079</u>	<u>\$.038</u>

See accompanying notes to consolidated financial statements.

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1971

1. The financial year end of the parent company was changed, in 1970, from September 30 to December 31.
2. Subsidiary companies whose accounts are included in these consolidated financial statements are Northwest Oils Limited, Amerco Investments Limited and Parquet Flooring Company Limited.

In the year ended December 31, 1971 the parent company disposed of its 60% interest in Conquest Oil & Mining Co. Limited, receiving therefor 36,000 shares of Acme Investments Limited (Acme). The investment in Acme is carried at \$36,000, the cost of the company's original investment in Conquest Oil & Mining Co. Limited, and is included in the balance sheet in "Shares in mining and oil exploration companies, at cost".

3. Marketable securities have been included in the balance sheet at aggregate cost, \$526,224, less a provision of \$206,662 for decline in overall value.
4. During the year ended December 31, 1971, options were exercised resulting in the issue of shares as follows:

Number of shares	Price per share	Total amount
17,500	\$.50	\$8,750

At December 31, 1971, there were options outstanding with respect to the shares of Merland Explorations Limited as follows:

Options held by officers of the company:

Number of shares	Price per share	When exercisable
50,000	\$.50	On or before June 30, 1972
17,500	.75	On or before June 30, 1972
15,000	1.00	After July 1, 1972 and on or before June 30, 1973
15,000	.75	On or before August 31, 1972
15,000	1.00	After September 1, 1972 and on or before August 31, 1973.

Options held by the manager of the Parquet flooring division of the company:

Number of shares	Price per share	When exercisable
10,000	\$.75	On or before February 29, 1972
10,000	1.00	After March 1, 1972 and on or before February 28, 1973
10,000	1.25	After March 1, 1973 and on or before February 28, 1974

5. During the year ended December 31, 1971 the parent company arranged bank credits totalling \$450,000 repayable over five years. Of this amount \$300,000 is secured by certain of the marketable securities, a general assignment of book debts and an assignment of the 7½% mortgage receivable and \$60,000 is secured by the company's 40% interest in petroleum and natural gas purchase contracts covering production proceeds from certain gas properties. It is proposed that the balance of the advances, \$90,000 will be assumed in 1972 by Conquest Oil & Mining Co. Limited which company holds the remaining 60% interest in the petroleum and natural gas contracts, and applied against the indebtedness of that company to Merland (included in "accounts receivable"). The \$90,000 has accordingly, been included in "bank advances repayable within one year" in the balance sheet.
Subsequent to December 31, the company has arranged further Section 82 bank advances of \$38,000. This additional loan is repayable over a period of five years and is to be used to liquidate certain current liabilities incurred for the building of the gas gathering system. Accordingly, such liabilities have been excluded from current liabilities.
6. There are accumulated losses and unclaimed development and exploration expenditures which may be available for deduction in determining the company's taxable incomes of future years.
7. The company has 7 directors and 4 officers, 3 of whom are directors. In the year ended December 31, 1971, no remuneration was paid to directors or officers for their services as directors or officers. The company is charged a management fee which includes charges for the services of certain officers.

PEAT, MARWICK, MITCHELL & Co.
CHARTERED ACCOUNTANTS
P.O. BOX 31
COMMERCE COURT POSTAL STATION
TORONTO, ONTARIO

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Merland Explorations Limited and subsidiaries as of December 31, 1971, and the consolidated statements of profit and loss and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company and subsidiaries at December 31, 1971 and the results of their operations and the source and application of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Ontario
April 24, 1972

PEAT, MARWICK, MITCHELL & CO.,
Chartered Accountants.

